



July 15, 2019

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue NW  
Washington, D.C. 20551  
E-mail: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

**Re: Notice of Proposed Rulemaking regarding Proposed Revisions to Federal Reserve Board (Board) Rules regarding the Definition of Control under the Bank Holding Company Act (BHCA) and the Home Owners' Loan Act (HOLA)**

**Docket No. R-1662 and RIN 7100-AF 49**

Dear Ms. Misback:

I write on behalf of The Insurance Coalition, a group of federally supervised insurance companies and other parties with an interest in sound insurance regulation. We share a common interest in federal regulations that apply to insurance savings and loan holding companies (ISLHCs). In this case, we write because the Notice of Proposed Rulemaking (the Proposal) would apply to our ISLHC members. We appreciate the opportunity to comment.

### **Executive Summary**

We support the Board's goals of providing greater certainty and transparency with respect to the rules governing "control" under the Bank Holding Company Act (BHCA) and Home Owners' Loan Act (HOLA) and welcome efforts to reassess some of the restrictions that have traditionally been applied in control determinations, including those applicable when a company divests control of a second company. We nevertheless believe that some elements of the Proposal are inadvertently unduly restrictive and, unless modified, would leave in place unnecessary hurdles for bank and savings and loan holding companies seeking to make non-controlling investments in other companies. We provide more detail on this and other comments below, and hope these suggestions are helpful as the Board finalizes the Proposal. The Insurance Coalition would be happy to provide further information or clarification should it be helpful to the Board's efforts.

### **I. Questions 5, 7 - Business Relationship Thresholds**

The Proposal establishes presumptions of control based on business relationships, board or management interlocks, and other factors at each of four tiers of voting stock ownership—less



than 5%; 5-9.99%; 10-14.99%; and 15-24.99%. The level of business relationships permitted at each tier without triggering a presumption of control varies inversely with the level of voting stock ownership.

#### Question 5

Question 5 of the Proposal asks whether the Board should permit greater or lesser amounts of business relationships under the proposed presumptions, and if so, what levels of business relationships should be permitted without triggering a presumption of control. We believe that the proposed limits on business relationships in each tier where restrictions apply are too stringent and would unnecessarily constrain useful investments by bank and savings and loan holding companies in nonbank companies, thwarting the public policy of encouraging new investment and innovation. Nonbank startups drive significant innovation in financial services; produce valuable products, services, and efficiencies; and often require a significant amount of early investment to be successful. We are concerned that unnecessarily low business relationship thresholds could inhibit critical investments by ISLHCs in FinTech, InsurTech, and other innovative startups that provide products and services that may benefit a broad range of American consumers.

For insurance companies, partnerships with FinTech startups through financial investments can be an important business and financial strategy aimed at harnessing the power of technology to improve access to products and enhance the customer experience. In particular, the GAO recently noted that the use of such technologies can benefit consumers through more individualized, risk-based pricing; increased convenience; and increased consumer choice.<sup>1</sup> More broadly, innovations in FinTech have helped financial services companies, including insurers and banking organizations, reach underserved communities as well as offer tools related to financial literacy. These insurance companies may also be a consumer of the startup's products and services. While these relationships would account for a very small percentage of an insurer's overall financial investments and business relationships, they can represent a higher percentage of a startup's revenue because the firm is small and starting out. Low business relationship thresholds may therefore inadvertently limit, or in some cases eliminate, critical financial support from bank and savings and loan holding companies in valuable, innovative products and services. Our suggestions are aimed at encouraging ongoing investment in such companies, which benefits consumers and others, while acknowledging circumstances in which the first company genuinely may exercise a controlling influence over the second company.

Additionally, for control purposes, companies have historically analyzed their investments based on the percentage of total *revenues* that the business relationship generates. However, under the Proposal, companies would also be required to analyze the *expenses* that the business relationship creates. We believe it is unnecessary to use expenses as a business relationship

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<sup>1</sup> GAO, *Insurance Markets: Benefits and Challenges Presented by Innovative Uses of Technology*, GAO-19-423 (Washington, D.C.: June 7, 2019).



measure, as the second company's revenues provide an adequate standard, and using expenses in addition or as an alternative unduly complicates analysis. The use of expenses may also perversely create an incentive for an investing company to become *more* involved in the business of the investee company in order to be able to track expense levels. Our recommendation is also consistent with the Board's historical practice of not relying on expenses as a component of the control analysis.

Accordingly, instead of the business relationship thresholds in the Proposal, we urge the Board to adopt the following tiered thresholds:

% of Voting Securities	Business Relationship
Less than 10%	N/A
10-14.99%	20% or more of second company's revenue
15-24.99%	10% or more of second company's revenue

We believe that these thresholds avoid unduly constraining the innovation and other benefits that insurers' non-controlling investments in other companies provide.

#### Question 7

The Proposal asks whether the presumptions should incorporate limits on business relationships in light of the economic significance of such relationships to both the first company and the second company, and whether it would be appropriate to apply different thresholds in the presumptions to measure the materiality of a business relationship to the first company versus the second company.

As noted above in our discussion of question 5, we believe the business relationship thresholds should focus on the investee company's revenues and should be higher for each tier where limits apply. When a large ISLHC makes an investment in a startup or other smaller company and has a business relationship with the investee company, in many cases, both the investment and the business relationship may be very significant to the investee. The business relationship thresholds should permit this without triggering control. If adopted as proposed, the thresholds could inadvertently limit ISLHCs' ability to make such investments without triggering a control presumption, contrary to public policy to encourage new investment in innovative products and services that broadly benefit consumers. Finally, we note that a large ISLHC's investments in a startup will typically be immaterial to the ISLHC, relative to the ISLHC's total investments and business relationships, limiting the ISLHC's incentive to attempt to exercise a controlling influence over the investee.

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## **II. Question 8 - Definition of "Revenue" and "Expenses"**



Question 8 asks whether the proposed measurement of business relationships for purposes of the presumptions is sufficiently clear, and whether companies have any difficulty measuring the economic significance of a business relationship as described in the presumptions. We suggested above that the Board eliminate, as unnecessary, expenses as a measure of business relationships. We believe that additional clarity with respect to the precise definition of “revenue” and “expenses” (assuming expenses are retained as a relevant measure) would be helpful.

Specifically, it would be helpful to understand whether these terms are based on GAAP accounting definitions or a different definition. In our view, because mutual insurance companies that are ISLHCs are not required to file GAAP accounting statements, ISLHCs should be permitted to calculate “revenues” and “expenses” using statutory accounting principles.

Relatedly, it would be helpful if the final rule confirmed that “revenue” refers not only to earnings from the sale of products and services, but also reflects earnings from other sources, including investment income, dividends and distributions, assets under management, etc. A similar clarification regarding the precise definition of “expenses,” if retained as a measure of business relationships, would also be helpful.

Question 8 also asks whether the proposed annual measurement period for business relationships is appropriate. We support a measurement period of annually or less frequently, because the collection of such data from startups in particular can be the subject of specific negotiations and semi-annual collection would be needlessly burdensome. We believe that annual measurement of business relationships is frequent enough to capture in real-time any emergence of a controlling influence, without an unnecessary regulatory and compliance burden.

### **III. Question 13 – Threats to Dispose**

Question 13 asks whether the Board should include a presumption that a company controls a second company when the first company has a significant voting stake in the second company, such as 10 percent or more, and threatens the second company with disposing of its shares in order to induce action or inaction by the second company. We support the Board’s Proposal not to include such a presumption. We agree with the Board’s view that investors who are unhappy with the business decisions of a company in which it invests should be able to divest of their investment, and that communicating this to companies they invest in is an important contributor to management discipline. This healthy interaction is related to investors’ ability to protect value of their investments and should not result in a presumption of control.

### **IV. Question 28 - Majority Ownership by a Third Party**

Question 28 in the Board’s Proposal asks whether the Board should create different presumptions for companies that are majority owned by a third party, and if so, which of the



proposed presumptions should include this differentiation. We support such differentiation, because we agree that it is reasonable to assume that an investor's potential controlling influence is more limited when the company in which it invests has a third party investor with a larger ownership position.

In particular, we believe that the business relationship thresholds that generally apply should be raised in cases where the company being invested in has a single majority owner. We believe that this differentiation better reflects situations in which the first company is able to exercise a controlling influence over the second company, which is inherently less likely where the second company is majority owned by a third party.

## **V. Convertible securities**

Under current Board regulations, securities that are “immediately” convertible into voting securities at the holder's option are presumed to be voting securities.<sup>2</sup> In practice, we understand that Board staff has often interpreted “immediately” and “at the option of the holder” elements of this definition to mean at any time in the future, even in circumstances where external events need to occur to allow the security holder to exercise the convertibility. The Proposal seems to take an even stricter approach to convertible securities: Rather than a *presumption* that convertible securities are voting securities, the Proposal would apparently conclusively deem a convertible instrument to be voting if it is “convertible into, exercisable for, exchangeable for, or otherwise *may become* a voting security.”<sup>3</sup>

We suggest a more flexible and realistic rule: When there are conditions on convertibility that have not been satisfied and that are not in the holder's exclusive control, these instruments should not be treated as voting instruments. In such cases, the security holder simply has no ability to exercise control because the security is not yet convertible. There is precedent for such an approach under current Board rules, which provide that preferred shares that allow the holders to vote for directors if dividends are in arrears are not treated as voting unless and until the arrearage occurs.<sup>4</sup> Consistent with this treatment, we believe that, in other instances of preconditions that are outside the holders' control, Board regulations should not treat the securities as voting securities until the precondition has been satisfied (or is clearly imminent).

## **VI. Question 55 - Contributed Capital**

Question 55 asks whether the Board should provide for any different presumptions of control under Regulation LL, and why. Under the Proposal, the same presumption of control based on total equity ownership applies for purposes of the BHCA and of HOLA. Regulation LL under

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<sup>2</sup> 12 CFR 225.31(d)(1)(i)

<sup>3</sup> Proposed 12 CFR 225.9 (emphasis added).

<sup>4</sup> 12 CFR 225.2(q)(2)(i); Letter to Timothy J. Mayopoulos, August 22, 2007.



HOLA currently includes a separate test under which a person who has contributed more than 25 percent of the capital of a company is deemed to have control of the company.

With respect to the contributed capital component of HOLA's definition of control and the Board's Regulation LL, we respectfully suggest that additional analysis and consideration is appropriate before the Board finalizes its interpretation of the meaning of the statutory phrase "has contributed more than 25 percent of the capital of such other company[.]"<sup>5</sup> On numerous occasions, the Chief Counsel's Office of the former-Office of Thrift Supervision publicly opined that contributed capital should be evaluated as the "stockholder's equity" shown on a company's financial statements, prepared in accordance with GAAP (including retained earnings).<sup>6</sup> Accordingly and critically, certain ISLHCs (and likely others in and outside of the banking industry) have relied on these opinions as they monitor investments and compliance with control standards. The Proposal indicates, however, that contributed capital has generally been understood to mean paid-in capital,<sup>7</sup> which appears to measure financial value differently than stockholders' equity. It is unclear to us whether the reference to paid-in capital in the Proposal was intended to propose a new approach to measuring contributed capital under HOLA or to clarify publicly the Board's current view of contributed capital. To ensure clarity of and alignment with Federal Reserve expectations, we suggest that the Board or its staff should assess and clarify whether ISLHCs should employ stockholders' equity or paid-in capital, or some other approach as alluded to below, as the appropriate measure of contributed capital.<sup>8</sup>

Accordingly, we respectfully request that the Board and its staff continue to study various approaches to determining contributed capital and engage with the public further before issuing a final rule that addresses contributed capital. In particular, we believe there would be great value in studying whether contributed capital should be assessed differently in different circumstances—e.g., assessing contributed capital one way in the context of investment in a startup company and a different way in the context of investment in a mature operating company. We also believe it is important to study when contributed capital should be assessed and how frequently it should be revisited—e.g., at the time of investment or upon any material changes to the company's capital structure. It also will be valuable to consider what level of burden ongoing compliance with contributed capital requirements places on ISLHCs and the companies in which they invest, some of which may not have internal accounting systems that are suited to providing the information necessary to fulfill any specialized reporting and monitoring

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<sup>5</sup> 12 U.S.C. 1467a(e)(2).

<sup>6</sup> Op. Sr. Dep. Chief Counsel (OTS), April 30, 1993; Op. Chief Counsel (OTS), September 25, 1992; Op. Chief Counsel, July 23, 1992; Op. Chief Counsel, December 22, 1989. *See also*, Williams, Savings Institutions: Mergers, Acquisitions and Conversions, §4.03[3], n.180.

<sup>7</sup> Proposal, n.94.

<sup>8</sup> For example, through the issuance of a legal interpretation or letter from the Office of the General Counsel.



requirements. We would welcome the opportunity to engage with Board staff on this topic and provide any information that would be helpful in assessing this important point.

## **VII. Treatment of Separate Account Investments**

While not a common or typical event, an insurer's separate account investments have, in the past, triggered an analysis by the Board regarding whether control presumptions have been triggered, and what commitments might be necessary by an insurance company to prevent separate account investments from triggering those presumptions in the future. Although separate account assets sit on insurers' balance sheets, the investments in separate accounts are directed by policyholders. Thus, we would support a clarification in the Proposal that separate account investments do not count when calculating an insurer's percentage of stock ownership in a company in which it has invested. In the alternative, we would support higher thresholds for separate account investments, because they are directed by policyholders, and/or a clarification of the ways in which separate account investments need to be structured to avoid triggering a rebuttable presumption of a controlling influence.

## **VIII. Harmonizing Final Rule with Other Regulations**

We believe it would be consistent with the Board's aims of increasing clarity and transparency, and reducing regulatory burden if, when the Proposal is finalized, other Board regulations that rely on the definition of control—such as Regulation O and W—could be harmonized with the Proposal as adopted to the extent that the statutes which they implement allow.

## **Conclusion**

We appreciate the opportunity to comment on the Proposal and look forward to continued engagement as the development of the Proposal continues. We support the Board's efforts to provide clarity and transparency regarding the rules governing control under the BHCA and HOLA. Please do not hesitate to contact Bridget Hagan ([bridget@cypressgroupdc.com](mailto:bridget@cypressgroupdc.com); 571-212-2036) with any questions regarding these comments.

Sincerely,

Bridget Hagan  
Executive Director, The Insurance Coalition